

INSIGHTS

SEC Lifts Ban on General Solicitation

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On July 10, 2013, the Securities and Exchange Commission (SEC), in a 4-1 vote, adopted a rule lifting the ban on "general solicitation" and advertising in Rule 506 offerings. The ban has historically barred issuers from publicizing fundraising efforts and performance numbers in connection with sales of securities. Under the new regime, issuers who take "reasonable steps" to verify that targeted potential investors are "accredited" can utilize general solicitation and advertising when offering their securities. Although the law does not define "reasonable steps," it is generally understood that receipt of tax returns or bank account statements from investors suffices. Notably, the new rule will not eliminate Rule 506(b), under which up to thirty-five non-accredited investors meeting certain "sophistication" requirements can receive information regarding a potential investment.

Importantly, the rule becomes effective sixty days after publication in the Federal Register. Therefore, fund managers should refrain from participating in general solicitation and general advertising until such date.

Under additional proposed rules, once the rule takes effect, a fund manager that wishes to publicly solicit and advertise must file (1) a Form D with the SEC fifteen days prior to fundraising and (2) an amended Form D within thirty days of the fundraising's conclusion. The rule amends Form D to include a "checkbox" to inform the SEC that the issuer completing the Form D is utilizing the new Rule 506 exemption. Additionally, the rule will require a fund manager to disclose its website, the securities offered through the general solicitation and the fund manager's method for verifying the accredited status of an investor.

In conjunction with the lift on the ban on "general solicitation," the SEC also voted to prohibit felons and other "bad actors" who engage in a "disqualifying event" from utilizing the reforms to Rule 506. The rule broadly defines bad actors to include both investment advisors and their principals, and a disqualifying event includes such occurrences as securities law violations, criminal convictions and other SEC disciplinary orders. Any "disqualifying event" that occurred before the rule's effective date must be disclosed to investors.

By lifting the ban on general solicitation, the SEC's new rule will likely increase the use of the Internet and the press as vehicles available to private fund managers for communicating Rule 506 offering information. Additionally, the adopted exemption will reduce the risks associated with accidental disclosure under the prior ban. However, general solicitation under the SEC's new rule may run afoul of the requirements for regulation exemptions granted by the Commodities Futures Trading Commission and private placement regimes of other countries. Absent further guidance from such entities, fund managers that rely on such exemptions should be wary of implementing general solicitation procedures.

In sum, upon the new rule's effective date and subject to increased reporting requirements, fund managers will gain access to a wider audience through fundraising solicitation and advertising methods previously unavailable under the ban.